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**IN THE CIRCUIT COURT OF THE SECOND JUDICIAL CIRCUIT,  
IN AND FOR LEON COUNTY, FLORIDA**

TARGET ENTERPRISE, INC., a foreign  
corporation,

Plaintiff,

CASE NO.: 2021-CA-002158

vs.

STATE OF FLORIDA DEPARTMENT OF  
REVENUE, an agency of the State of Florida,

Defendant.

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**FINAL JUDGMENT FOR PLAINTIFF**

This action was tried before the court on November 2, 2022. On the evidence presented, the Court finds as follows:

**FINDINGS OF FACT**

A. Target Enterprise, Inc. ("TEI") is a subsidiary of Target Corporation ("Target"). Both TEI and Target are headquartered in Minnesota. Target is a nationwide online and brick-and-mortar retailer. TEI earns revenue from providing services to Target and certain other third parties.

B. In 2011, TEI and Target entered into a Retail Operating Services Agreement (the "ROSA"). [Plaintiff's Exhibit ("Plaintiff's Ex.") P1] Under the terms of the ROSA, TEI was to provide Target (1) merchandising services, (2) marketing services, and (3) strategy and management consulting services. In return for those services, Target agreed to compensate TEI.

C. Ernst & Young ("EY") was engaged to prepare a transfer pricing study to determine the arms' length cost for the services provided by TEI to Target under the ROSA. During the period at issue, EY prepared a transfer pricing report in 2016 and updated that report in 2017. [Plaintiff's Exs. P13 and P14] TEI set the pricing of its services in accordance with these transfer pricing reports. [Trial Transcript ("Tr. Trans.") 41:12-19] The Department did not question the transfer pricing conclusions of EY. [Tr. Trans. 44:22-25]

D. TEI owned no real or tangible personal property in Florida during the audit period. [Plaintiff's Exs. P2-P4]

E. During the audit period, TEI had over 11,000 employees, almost all of whom were located at TEI's headquarters in Minnesota. TEI did have a small amount of payroll attributable to Florida. [Plaintiff's Exs. P5-P7]

F. Chapter 220, Florida Statutes, provides for a Florida income tax on corporations. The State of Florida Department of Revenue ("DOR") conducts audits of taxpayers' records to determine if the appropriate income tax was calculated, reported, and remitted to DOR.

G. An audit was initiated by DOR to determine TEI's compliance with Florida's income tax laws for TEI's fiscal years ending January 31 of 2017, 2018, and 2019 (the "Period"). [Plaintiff's Ex. P16 at p. 1]

H. During the course of the DOR's audit, the auditor visited TEI's headquarters to review the documents he requested. [Tr. Trans. 143:24-144:4] The auditor's visit lasted approximately one week. [*Id.*]

I. There is no evidence in the record suggesting that TEI failed to provide documents requested by the auditor. [See Plaintiff's Ex. P16]

J. Mr. Michael Daman, Director – State Tax, at TEI testified at the trial. Mr. Daman explained that the auditor never questioned the detail of any of the documentation provided by TEI. [Tr. Trans. 51:19-22; 59:22-25; 65:17-66:8; 130:25-131:22; 136:17-138:3]

K. DOR proposed adjustments to TEI's corporate income tax liability for the Period. [Plaintiff's Ex. P12] These adjustments related to the proper methodology used to attribute TEI's receipts from the sale of services to Target under the ROSA for purposes of determining TEI's Florida sales factor, and thus, its Florida taxable income. [See *id.*]

L. DOR contended that TEI was required to attribute its service receipts to Florida based on a fraction the numerator of which was the retail square footage of *Target* stores in Florida and the denominator of which was the retail square footage of *Target* stores across the country. [*Id.* at p. 9]

M. TEI countered that DOR's own administrative rule required that its sales receipts are attributed to Florida based on the location of the income producing activity directly engaged in by TEI, which is determined based on the location of the costs to perform those services. [*Id.* at pp. 5-6] Because the location of the costs to perform services under the ROSA were those of TEI employees residing in Minnesota, TEI argued that DOR's

administrative rule attributed none of TEI's sales receipts to the State. [*Id.*; Plaintiff's Exs. P8-P10]

N. Unable to agree on the proper sales factor for the apportionment formula, DOR issued an assessment to TEI for additional corporate income taxes for the Period.

### **CONCLUSIONS OF LAW**

O. All corporations doing business within and without Florida must apportion their federal adjusted gross income to the State. § 220.15, Florida Statutes. The general rule for Florida corporate income tax purposes is that a taxpayer apportions business income to the State by using a three-factor formula comprised of a payroll, property, and double-weighted sales factor. See § 220.15(1), Florida Statutes. Each factor is comprised of a numerator that quantifies a taxpayer's business activity in Florida and a denominator that quantifies the taxpayer's business activity everywhere. The dispute, in this case, relates to the computation of TEI's sales factor numerator.

P. Because TEI earned revenue from the sale of services, Fla. Admin. Code 12C-1.0155(2)(l) (the "COP Rule") prescribes how to derive the sales factor. The COP Rule provides that sales revenue is attributable to Florida if the "income producing activity" responsible for generating the sales revenue is performed by the taxpayer in Florida. If the "income producing activity" is not conducted solely in Florida, the COP Rule states that the sales revenue is attributable to Florida if the "greater proportion of

the income producing activity is performed in Florida, based on costs of performance."

Q. The COP Rule looks to the location where the costs were incurred to perform the relevant services. If the greater proportion of those costs were incurred outside Florida, the taxpayer has "0" sales attributable to Florida and, accordingly, the sales factor under Section 220.15, Florida Statutes, would be "0" because the numerator of the sales factor would be "0". If the greater proportion of those costs were incurred inside Florida, then 100% of the receipts are recorded in the numerator of the sales factor under Section 220.15, Florida Statutes.

R. DOR's primary argument at trial was that TEI failed to provide sufficient documentation to support the use of the costs of performance apportionment under the COP Rule. For this reason, DOR maintains, it was entitled to use its equitable authority under Section 220.44, Florida Statutes, to craft a new methodology for TEI's sales factor.

S. Mr. Daman provided testimony at trial that TEI provided state-by-state payroll, property and sales apportionment workpapers and working trial balance information to the auditor for review. [Tr. Trans. 50:25-51:14; Plaintiff's Exs. P2-P10] This documentation was provided to the auditor in response to DOR's request that TEI support its use of costs of performance under the COP Rule. [Plaintiff's Ex. 16] Mr. Daman explained that the requested documentation was made available to the auditor to review in

person and TEI shared documentation with the auditor electronically through a secure file sharing site. [Tr. Trans. 42:18-25; 45:4-11; 184:14-19]

T. Mr. Daman testified that the documentation provided to the auditor relating to the use of costs of performance is the same documentation routinely provided and accepted by every other state taxing authority with apportionment rules that mirror those outlined in the COP Rule. [Tr. Trans. 53:15-54:19]

U. This Court concludes that TEI provided sufficient documentation to support TEI's implementation of the COP Rule. The COP Rule states that receipts from the sale of services are considered "Florida sales" only if the greater proportion of the costs of performance are incurred in Florida. For provision of the services at issue, the most relevant cost of performance is payroll. Because the overwhelming portion of TEI's payroll costs were incurred outside Florida, none of the receipts from the sale of TEI's services should be considered Florida sales. Here, for the 2016 tax year, TEI's payroll cost information demonstrated that only 0.068% (\$813,695.00) of TEI's total payroll was Florida payroll, while 94.90% (\$1,152,945,070.00) was attributable to Minnesota. [Plaintiff's Ex. P5] The tax years 2017 and 2018 provide similar payroll numbers. [See Plaintiff's Exs. P6 and P7] According to the relevant evidence, the greater portion of TEI's payroll costs were incurred outside Florida. Pursuant to the operation of DOR's own

administrative rule, therefore, the numerator of TEI's sales factor relating to receipts received from providing the disputed services was "0."

V. DOR relies on Section 220.44, Florida Statutes, for the audit adjustments in this case. That statute permits DOR to make adjustments to income between related parties to more reasonably reflect business activity in the state. According to DOR, it is permitted to rely on Section 220.44, Florida Statutes, because TEI failed to provide sufficient documentation to supports its use the costs of performance approach under the COP Rule.

W. Section 220.21, Florida Statutes, provides that DOR "may require any taxpayer or class of taxpayers, by notice or by regulation, to make such returns and notices, render such statements, and keep such records as the director deems necessary to determine whether such taxpayer or taxpayers are liable for tax under this code."

X. The Department's own regulation interpreting Section 220.21, Florida Statutes, states that during the course of an audit "required books and records must be *available for inspection* by the Department of Revenue." Fla. Admin. Code 12C-1.021(2) (emphasis added).

Y. Here, DOR requested that TEI provide documentation relating to its use of the COP Rule. Specifically, DOR requested "for the sales factor, if the taxpayer used the cost of performance method, please provide justification for this, including the Florida applicable law." [Plaintiff's Ex. 16 at p. 4]

Z. Mr. Daman explained that in response to this document request, TEI provided its payroll apportionment worksheets and related supporting documentation. [Tr. Trans. 50:25-51:14; Plaintiff's Exs. P2-P10] This documentation, Mr. Daman noted, was provided to the auditor during his week-long in-person visit to TEI's headquarters and TEI shared documentation with the auditor electronically through a secure file sharing site. [Tr. Trans. 42:18-25; 45:4-11; 184:14-19] In addition, TEI directed DOR to the COP Rule as justification for its use of the costs of performance methodology. [Plaintiff's Ex. 16 at p. 18]

AA. Based on the testimony of Mr. Daman, it is clear that TEI complied with its duty to make any and all books and records "available for inspection" by DOR.

BB. It is also clear based on the testimonial and documentary evidence presented at trial that DOR never questioned the documentation made "available for inspection" by TEI that justified its application of the cost of performance method. For example, DOR Form DR-1215 (Notice of Intent to Make Audit Changes) makes no mention of TEI's failure to cooperate in providing documentation to support the use of the COP Rule. [See Plaintiff's Ex. 12 at p. 8]

CC. This Court concludes that TEI complied with its duty to make any and all requested books and records "available for inspection" by DOR.



DD. This Court further holds that TEI provided sufficient documentation in support of its use of the costs of performance method outlined in the COP Rule. The COP Rule operates in two steps. First, it is necessary to determine the taxpayer's "income producing activity." Once determined, the COP Rule then requires a balancing of the costs incurred to perform that activity. If the greater proportion of the costs to perform the activity are incurred outside Florida, none of the receipts are apportioned to Florida and the numerator of the taxpayer's sales factor is "0." By contrast, if the greater proportion of the costs to perform the activity are incurred in Florida, 100% of the receipts are apportioned to Florida and included in the taxpayer's sales factor numerator. Here, there can be no question that TEI's "income producing activity" was performing services under the ROSA. These services were performed by employees of TEI. The best evidence of the costs to perform these services would be TEI's payroll apportionment workpapers. These workpapers make abundantly clear that the greater proportion of the costs to perform TEI's services were incurred outside Florida. This evidence was made "available for inspection" to DOR during the audit. TEI provided documentation to DOR which fully supported TEI's compliance with the COP Rule. In sum, the Department is without authority to rely on Section 220.44, Florida Statutes, to reconstruct TEI's sales factor for apportionment purposes.

EE. Even if it were reasonable for DOR to rely on Section 220.44, Florida Statutes, this Court finds that DOR's proposed apportionment methodology bears no relevant relationship to *TEI's* business activity in the State of Florida. The purpose of state apportionment rules is to impose tax commensurate with the *taxpayer's* business activities in the taxing state. Pursuant to the terms of the ROSA, TEI, headquartered in Minnesota, and with the vast majority of its business activity in Minnesota, provides certain services to Target, also headquartered in Minnesota. As explained by Mr. Daman, Target employees can choose to accept or reject these services. [Tr. Trans. 41:20-42:10] Target compensates TEI to perform these services on its behalf. It is clear from the facts presented that TEI is not directly providing services to individual Target retail locations. TEI is providing services to Target. How – or if – Target chooses to use these services in its retail stores in no way impacts TEI's entitlement to receive compensation under the ROSA.

FF. DOR determined TEI's sales factor should be determined by the retail square footage of Target's retail stores within and without Florida. [Plaintiff's Ex. 12 at p. 9] However, DOR's proposed formula conflates *Target's* business activity in Florida with *TEI's* business activity. TEI is a distinct legal entity separate and apart from Target. For these reasons, DOR's alternative apportionment methodology to determine TEI's sales factor must be rejected.


In light of the foregoing, it is ORDERED AND ADJUDGED:

1. TEI is entitled to final judgment in its favor as to all claims raised in its Complaint.

2. The DOR's corporate income tax assessment issued to TEI for the tax years 2016-2018 is abated in full.

3. The court reserves jurisdiction to enter such further Orders as may be required which are consistent with this Judgment.

ORDERED at Tallahassee, Leon County, Florida, on this Monday, November 28, 2022.

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Lee Marsh, Circuit Judge  
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cc: All counsel of record